IOWA UTILITIES BOARD
Energy Section

Docket No.: RPU-2012-0001
Utility: MidAmerican Energy Company
Memo Date: October 1, 2012

TO: The Board

FROM: Dan Fritz, Gary Stump, John Pearce, Leslie Cleveland, Brenda Biddle, Janet McGurk, Jim Kellenberg

SUBJECT: Settlement Memo

Introduction and Procedural History

On February 21, 2012, MidAmerican filed with the Utilities Board (Board) a proposed annual increase in its Iowa retail electric revenue of approximately $76 million, or 6.7 percent over its current revenues; this increase, if approved, would not take place until 2013. Pursuant to Iowa Code § 476.6(10), ten days after its February 21, 2012, filing, MidAmerican implemented a temporary rate increase of approximately $38.7 million, or about 4 percent over current Iowa retail electric revenue, subject to refund.

MidAmerican has a revenue freeze agreement in place through December 31, 2013, but the agreement allows MidAmerican to exit the revenue freeze if its return on equity falls below 10 percent. In its filing, MidAmerican said its return on equity was 8.94 percent for the 2011 test year.

MidAmerican asked for approval of two adjustment clauses, one for environmental compliance and the other for coal and coal transportation. MidAmerican stated the combined clauses would be capped at $38.7 million in 2012 and $76 million in 2013. Under MidAmerican's original proposal, the two adjustment clauses would end on December 31, 2013, unless MidAmerican requested a one-year extension from the Board. The Board held six consumer comment hearings throughout MidAmerican's service territory.

On March 15, 2012, Deere & Company (Deere) and the Iowa Industrial Group (IIG) each filed a petition to intervene. The Board issued an order granting the interventions on March 29, 2012. On June 8, 2012, Alcoa Inc. (Alcoa) filed a petition to intervene. The Board issued an order granting Alcoa's petition on June 14, 2012. The Consumer Advocate is also a party to these proceedings.

On March 16, 2012, the Board issued an "Order Docketing Tariff, Establishing Procedural Schedule, Requiring Additional Information, Granting Waiver, and Approving Corporate Undertaking." The waiver requested by MidAmerican

related to rate case filing requirements for advertising and rate case expense, which MidAmerican said it was not seeking to recover in this rate proceeding.

On April 20 and May 22, 2012, the Board issued orders requiring MidAmerican to file additional information and coal-related contracts. MidAmerican filed additional information on May 18 and June 1, 2012. The contract filing requirement is ongoing, and MidAmerican has filed additional contracts.

On July 5, 2012, Consumer Advocate filed its direct testimony. In summary, Consumer Advocate recommends that the Board accept MidAmerican's proposed riders at the levels proposed. In agreeing to the MidAmerican proposal Consumer Advocate provides testimony that justifies a revenue increase ranging from $116,497,790 based on an ROE of 8.5 percent to $134,769,373 based on an ROE of 9.4 percent. Consumer Advocate accepts all MidAmerican adjustments with the exception of the revenue collection period used in calculating cash working capital. In addition, Consumer Advocate includes four additional adjustments relating to transmission maintenance expense, nuclear maintenance expense, other power production maintenance expense, and Iowa Utility Association dues.

On July 27, 2012, MidAmerican, Consumer Advocate, and IIG filed a "Joint Motion for Approval and Settlement Agreement." MidAmerican, Consumer Advocate, and IIG said that they had resolved all issues in this proceeding. They further asked the Board to modify the procedural schedule to eliminate the filing of additional testimony and briefs, and waive the requirement found in 199 IAC 7.18(2) to hold a settlement conference. Finally, the three settling parties asked that the Board proceed to issue an order approving the proposed settlement without condition or modification, or promptly schedule a hearing should the Board determine it needs to further develop the record before ruling on the proposed settlement.

On July 30, 2012, Deere filed a statement of position indicating that it did not oppose or contest either the proposed settlement or the joint motion. Deere specifically joined in the request to waive the settlement conference and waived its rights to receive notice of or participate in such a conference.

On August 1, 2012, Alcoa filed a statement of position indicating that it did not contest the proposed settlement or joint motion. Alcoa joined in the request that the requirement for a settlement conference be waived and that any remaining testimony or briefing be eliminated.

The Board issued an order on August 2, 2012, modifying the procedural schedule and granting waiver. The Board modified the procedural schedule to eliminate any further requirements for filing of testimony and briefs. However, the Board indicated that the hearing date of October 1, 2012, set in the March 16, 2012, order would be retained so that the Board may ask any questions it may have on the proposed settlement. The Board indicated that it might ask any questions it had by written order and that if there is any change to the hearing

date or the hearing becomes unnecessary, the Board will issue a subsequent order. The Board also waived the requirement to hold a settlement conference pursuant to 199 IAC 7.18(2).

On September 26, 2012, the Board issued an order cancelling the hearing.

Legal Issues

Iowa Code § 476.6(8) allows establishment of automatic adjustments of rates and charges as long as the charges are first filed with the Board, although the statute does not mandate that the Board adopt any particular rider. Rule 199 IAC 20.9 provides guidelines for recovery of fuel costs through automatic adjustments and allows utilities to pass-through certain types of non-fuel costs that meet the five guidelines set forth in the rules. The five guidelines contained in the rules provide that an adjustment clause is appropriate to recover only those costs which are:

(1) Incurred in supplying energy;
(2) Beyond the direct control of management;
(3) Subject to sudden important change in level;
(4) An important factor in determining the total cost to serve; and,
(5) Readily, precisely, and continuously segregated in the accounts of the utility.

It is important to note that even if a proposed clause meets the five criteria contained in the rule, the Board is not mandated to approve the automatic adjustment clause. Automatic adjustment clauses allow utilities to recover costs over which the utility has little or no control, with increases or decreases in those costs being passed dollar for dollar to customers without the necessity of a rate case proceeding, easing the administrative burden and reducing regulatory costs that are ultimately reflected in customers' rates. Interstate Power and Light Company currently has an energy adjustment clause, an energy efficiency cost recovery factor (which is an automatic adjustment mechanism but with specific statutory authority in Iowa Code § 476.6(16)"g"), and a transmission rider. MidAmerican has an energy efficiency cost recovery rider. Both utilities utilize the purchased gas adjustment for their gas operations.

The proposed settlement revised MidAmerican’s proposal by imposing a fixed amount to be recovered each year. Because a fixed amount would be recovered, it would be more appropriate to call the clause a surcharge, and not an automatic cost adjustment clause. Arguably, a surcharge would not have to meet the five criteria contained in 199 IAC 20.9. MidAmerican’s prefiled testimony does, however, contain testimony justifying its proposal under each of the five criteria contained in the rule.

In evaluating a proposed settlement, the Board’s rules provide “[t]he board. . .will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in

the public interest." 199 IAC 7.18. The record in this proceeding, as summarized in the remainder of this memorandum, supports the appropriate findings. In examining a settlement, the Board has traditionally looked at the settlement as a whole; in other words, a settlement can be reasonable even though each individual issue might not have been decided by the Board the same way, had the docket gone to full hearing.

Settlement Summary

The proposed settlement would result in an aggregate increase to MidAmerican's Iowa electric retail revenue by $38.7 million in 2012 and $76 million during calendar year 2013. The proposed settlement states that both Consumer Advocate's and MidAmerican's test year revenue requirement evidence is consistent with this result. The proposed settlement provides that these revenue increases shall be recovered through a single adjustment clause. The proposed settlement provides that the adjustment clause shall recover costs on a per kWh basis for all customers, except industrial customers with demand (kW) charges; for those customers, there will be both a per-kW demand and per-kWh component.

To ensure there is no over or under collection, the proposed settlement provides that there is to be an annual reconciliation. If there is an over or under recovery in 2012, it will be factored into the adjustment clause for 2013 on a per-kWh basis. Any over or under recovery in 2013 will be included as a pro forma adjustment, reflecting a three-year amortization, in the revenue requirement in the first general rate case applicable upon termination of the adjustment clause. However, there is to be no reconciliation if the adjustment clause is terminated prior to December 1, 2013, and the parties agree that no other refund obligation exists related to the 10-day implementation of temporary rates that have been used to implement the adjustment mechanism in this proceeding.

The proposed settlement leaves in place the revenue sharing mechanism that MidAmerican has been operating under, with the following modifications. The MidAmerican Iowa electric revenue sharing return on equity threshold is reduced from 11.75 percent to 10 percent; if MidAmerican's earnings do not reach 10 percent, there is no revenue sharing.

If MidAmerican's calculated Return on Equity exceeds 10 percent, then 20 percent of the revenues between 10 and 10.5 percent shall be returned to customers. For earnings between 10.5 percent and 11.75 percent, 50 percent is returned to customers. For earnings between 11.75 percent and 13 percent, 75 percent is returned to customers. Finally, for earnings over 13 percent, 83.3 percent is returned to customers.

The customers' share of any revenue sharing funds are to be used to reduce the investment in Walter Scott, Jr. Energy Center Unit No. 4, MidAmerican's newest coal facility in Council Bluffs, Iowa.

The proposed settlement provides that the parties agree not to seek any rate change to become effective in retail electric sales prior to January 1, 2014, beyond the rate changes addressed in the proposed settlement and changes permitted by Iowa Code §§ 476.6(16) and (22). However, the settlement gives MidAmerican the authority to request a general increase in 2013. In the event a general rate proceeding is commenced in 2013 and temporary rates are implemented in 2013, such temporary rates shall supersede the 2013 adjustment clause rates and only the applicable reconciliation provisions will remain. None of the parties are obligated to support continuation of the adjustment clause beyond 2013.

The proposed settlement also provides that prior to MidAmerican's next Iowa electric general rate case proceeding, MidAmerican shall review its generation depreciable life assumptions and review and update as necessary its 2011 electric depreciation study. Finally, the proposed settlement provides it shall not become effective unless and until it is approved by the Board in its entirety without condition or modification, unless otherwise agreed by the parties.

Staff Discussion

This is a unique rate case. Instead of seeking a revenue requirement based on the totality of the utility's revenue, expenses, capital structure, and rate of return, MidAmerican is seeking a limited increase based on increased expenditures for environmental compliance, coal and coal transportation. The settlement provides that both MidAmerican's and Consumer Advocate's respective revenue requirements would support the increase being sought by MidAmerican. Staff's review of the evidence submitted in this proceeding confirms that the electric revenue increase proposed by MidAmerican is reasonable.

One of the more significant features of MidAmerican's original proposal as summarized in its prefiled testimony was the interrelationship of the two adjustment clauses in implementing (or giving effect to) the annual cost caps. MidAmerican stated unequivocally that the annual cost caps would be absolute. Because the environmental cost adjustment clause was calculated first, this effectively limited the costs that could be recovered through the fuel adjustment clause. As a result, sizable portions of coal and coal transportation costs not recovered through MidAmerican's base tariff rates would likewise not have been recoverable through the fuel adjustment clause. The cost caps in MidAmerican's proposal meant that 69 percent of MidAmerican's estimated incremental coal and coal transportation costs would not have been recoverable in 2012, and 46 percent would not have been recoverable in 2013.[1] While the proposed settlement combined the two adjustment clauses originally proposed by MidAmerican, the limits as to what can be recovered under the cost cap remains intact; MidAmerican is not recovering all the coal and transportation costs that would be supported by its prefiled testimony.

[1] Exhibit NGC-1, Schedule E.

Some of MidAmerican's coal freight contracts are with the Burlington Northern Santa Fe Railroad (BNSF); both MidAmerican and the railroad are subsidiaries of Berkshire Hathaway. Pursuant to Board orders issued April 20 and May 22, 2012, MidAmerican submitted additional information about its business dealings with BNSF. The information supplied by MidAmerican indicates that its negotiations and resulting contracts with BNSF were arms-length negotiations and the shipping rates obtained were reasonable, given the current market.

The environmental cost adjustment clause proposed by MidAmerican seeks to recover depreciation expenses for projects that were approved by the Board in MidAmerican's emissions plan and budget (EPB) dockets, projects approved by the Board in a ratemaking principles docket (RPU-02-10), and surface impoundment projects associated with the management of coal combustion by-products. MidAmerican provided a detailed accounting for the various projects, and the costs MidAmerican seeks to recover are consistent with those approved in the EPB and ratemaking principle dockets; competitive bidding was used for projects approved in the EPB process. While the surface impoundment projects have not previously been before the Board, those projects have been permitted by the Iowa Department of Natural Resources and are required by environmental regulations; the evidence submitted in this proceeding show the amounts spent to be reasonable.

There is also a portion of the environmental cost adjustment clause related to operation and maintenance expenditures. The amount MidAmerican seeks to recover is consistent with those provided in MidAmerican's recent EPB filings.

The proposed settlement combines MidAmerican's originally proposed environmental cost adjustment clause and fuel adjustment clause tariffs into a single Revenue Adjustment Clause.[2] Rate elements for 2012 from the previous two tariffs are combined by customer class. However, unlike the original proposal, the combined tariff also specifies the rates that are to become effective in 2013. Under MidAmerican's original proposal, the 2013 rates were estimated and subject to final Board approval in a subsequent tariff filing. The rates in 2012 and 2013 are based on the cost cap amounts specified and supported in MidAmerican's original proposal (i.e., $37.8 million in 2012 and $76 million in 2013), and apply uniformly across MEC's three rate zones.

As in its original proposal, MidAmerican will file annual reports that reconcile actual revenues collected with the amounts allowed for recovery, by customer class.[3] However, unlike the original proposal, the amounts allowed for recovery

[2] For example, demand-metered Industrial customers would pay combined rates of $0.00171/kWh plus $0.26/kW, rather than separate rates of $0.00076/kWh plus $0.26/kW under the environmental cost adjustment clause and $0.00095/kWh under the fuel adjustment clause.

[3] And as in the original proposal, customer class allocations of the amounts allowed for recovery will be updated for purposes of making year-end reconciliations by customer class (*Joint Motion for Approval and Settlement Agreement*, July 27, 2012, Appendix B, p. 2) – i.e., based on

will be fixed amounts (i.e., the cost cap amounts of $37.8 million in 2012 and $76 million in 2013), which will not be subject to later revision based on actual expenditures. In this respect, the revenue adjustment clause will function more like a fixed-rate surcharge than a variable cost adjustment clause (consistent with IIG's recommendation presented in testimony). Also unlike the original proposal, no over/under collections beyond the 2012 reconciliation amount will be factored into the revenue adjustment clause. The clause will terminate on December 31, 2013, unless MidAmerican requests and the Board approves a one-year extension. The clause will also terminate if MidAmerican implements temporary rates for a general rate proceeding. Any subsequent over/under collections after 2012 will be reflected in MidAmerican's next general rate case, based on a three-year amortization.

All of the parties view MidAmerican's methods for allocating costs among customer classes as generally reasonable and based on methods previously approved by the Board. The earlier error in calculating the Average and Excess allocator[4] will be corrected in the 2012 rates through the year-end reconciliation[5] and has been corrected in designing the 2013 rates.[6] The settlement rate design and methods for reconciling revenues and costs are reasonable.

As part of the settlement, MidAmerican would also continue to operate under a revenue sharing mechanism similar to how it has for the past eleven years; therefore, a capital structure does not need to be determined in this case. The return on equity rate of 10 percent is the new threshold used for determining the amount of sharing and is a significant decrease from the 11.75 percent used in the most current version of the sharing mechanism. As pointed out by MidAmerican, the 10 percent return on equity is the same return on equity approved by the Board in Interstate Power and Light's electric rate case, Docket No. RPU-2010-0001, decided on January 11, 2011. It is also below the 10.15 percent average return on equity approved for the electric companies for the time period December 2010 to November 2011 as presented in MidAmerican's response filed April 2, 2012. Finally, a 10 percent return on equity was also the level set that would allow MidAmerican to end the rate freeze. Although the 10 percent return on equity threshold is higher than the return on equity range of 8.5 percent to 9.4 percent Consumer Advocate found reasonable for MidAmerican, Consumer Advocate was not determining an appropriate return for the revenue sharing mechanism, but rather for determining what MidAmerican's revenue deficiency would be. Consumer Advocate did not take issue with the 10 percent

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updated allocation factors such as MidAmerican's revised Average and Excess factor for demand-related costs (*Joint Motion for Approval and Settlement Agreement*, July 27, 2012, Appendix A).

[4] *MidAmerican Energy Company Response to the Iowa Utilities Board's April 20, 2012, Order Requiring Additional Information*, Environmental Cost Adjustment Question 7, pp. 14-16, Attachment 1.

[5] *Joint Motion for Approval and Settlement Agreement*, July 27, 2012, Appendix A, p. 1.

[6] *Joint Motion for Approval and Settlement Agreement*, July 27, 2012, Appendix A, p. 2.

return on equity threshold. By reducing the threshold from 11.75 percent to 10.0 percent, the opportunity for sharing to occur is increased significantly, which would benefit the customer.

Recommendation

Rule 199 IAC 7.18 provides that the Board will not approve a settlement unless it is "reasonable in light of the whole record, consistent with law, and in the public interest." This is an unusual rate case because instead of seeking a revenue requirement based on the totality of the utility's revenue, expenses, capital structure, and rate of return, MidAmerican is seeking a limited increase based on increased expenditures for environmental compliance, coal, and coal transportation. The settlement provides that both MidAmerican's and Consumer Advocate's respective revenue requirements would support the increase being sought by MidAmerican

The amounts allowed for recovery will be fixed (i.e., the cost cap amounts of $37.8 million in 2012 and $76 million in 2013), and will not be subject to later revision based on actual expenditures. In this respect, the revenue adjustment clause will function more like a fixed-rate surcharge than a variable cost adjustment clause.

Staff recommends that the Board direct the General Counsel to draft for the Board's consideration an order approving the settlement in Docket No. RPU-2012-0001.

RECOMMENDATION APPROVED

/RPU-2012-0001 Team

IOWA UTILITIES BOARD

/s/ Elizabeth S. Jacobs *10-3-12*
Date

/s/ Darrell Hanson *10-5-12*
Date

/s/ Swati A. Dandekar *10-3-12*
Date